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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 224

THE HANOVER BANK, EXECUTOR, ET AL.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

JACOB A. and BERTHA L. GOLDFARB,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONERS

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Opinions Below

Two cases are jointly present for review. The findings of fact and opinion of the Tax Court in *Hanover Bank (Gourielli)* (R. 76-81) are reported at 33 T. C. 357. The findings of fact and opinion of the Tax Court in *Goldfarb* (R. 130-135) are reported at 33 T. C. 568. The single opinion of the court of appeals in both cases (R. 139-151) is reported at 289 F. 2d 69.

Jurisdiction

The judgment of the court of appeals was entered on April 13, 1961 (R. 151). A joint petition for a writ of certiorari was filed July 11, 1961 and was granted October 9, 1961 (R. 153). The jurisdiction of this Court rests on 28 U. S. C. 1254 (1).

Question Presented

Were petitioners entitled to amortize bond premium [in *Gourielli* on purchases of Appalachian Electric Power Company 3¾% 1981 Series First Mortgage Bonds, and in *Goldfarb* on purchases of Arkansas Power & Light Company 4¼% 1983 Eighth Series First Mortgage Bonds] with reference to the special call price, as an "amount payable on maturity or earlier call date" within the meaning of Section 125 of the Internal Revenue Code of 1939, or may the statutory reference be qualified to encompass only the amount payable at a higher general call price?

Statute Involved

The statutory provisions involved are Sections 23(v) and 125 of the Internal Revenue Code of 1939, as amended by the Revenue Act of 1942, c. 619, §126, 56 Stat. 822 and as amended by the Revenue Act of 1950, c. 944, §217(a), 64 Stat. 941. As the provisions are lengthy, the pertinent text is set forth in Appendix A.

Regulations Involved

The regulations involved are Treasury Regulation 118, Section 39.125(b), (c) (1953). As the provisions are lengthy, the pertinent text is set forth in Appendix B.

Statement

The two cases presented for review involve closely related fact situations and an identical legal issue. They were decided in a single opinion by the court of appeals for the Second Circuit.

The Hanover Bank Executor, et al. *v.* Commissioner of Internal Revenue (*Gourielli* Case)

Petitioner Gourielli (now deceased) purchased Appalachian Electric Power Company (hereafter called Appalachian) First Mortgage Bonds 3¾ per cent, 1981 series (hereafter called the 1981 series) at 117½ and sold them at 115½ as shown in the following table:

Principal Amount	Date Purchased	Date Sold	Gross Sales Price	Cost	Commissions on Purchase	Commissions on Sale
130,000	10/ 8/53	11/12/53	$150,150	$152,750	$ 325	$ 325
300,000	10/14/53	11/18/53	346,500	352,500	750	750
110,000	10/23/53	11/27/53	127,050	129,250	275	275
540,000			$623,700	$634,500	$1,350	$1,350

The purchases were made through the New York brokerage firm of Hirsch & Company. The purchase price was paid in cash.

The issuance and redemption of the bonds were governed by the provisions of the Mortgage and Deed of

Trust dated December 1, 1940 (Ex. 2-B; R. 7).[1] Pursuant thereto, the bonds were redeemable prior to maturity at the option of Appalachian upon thirty days' call notice at either a general redemption price payable out of general funds or a special redemption price payable out of special funds. During the twelve-month period ending May 31, 1954, the general redemption price was 105⅜ and the special redemption price was 102⅜.

The governing indenture required that cash be deposited annually with the corporate trustee pursuant to two formulae. One was a percentage of the original indebtedness (Ex. 3-C, 28-30; R. 7). Amounts deposited pursuant to this provision could be used only for the redemption at the special price of the 1981 series bonds. The other formula was a percentage of gross revenues, less the amount spent during the year on maintenance (Ex. 2-B, 151-160; R. 7). Amounts deposited pursuant to this provision could also be used only for redemption of any of the series issued under the indenture at the special call price. In each case the company had the option, with certain limitations, of depositing bonds or certifying property additions in lieu of making deposits in cash. Appalachian elected not to make cash contributions. Instead, it certified property additions (Ex. 4-D; R. 7). The indenture also provided that bonds of any series might be redeemed at the special price from the proceeds of released properties (Ex. 2-B, Sec. 65: Ex. 3-C, Sec. 2; R. 7).

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1. "Ex." references are to exhibits which are separately certified in the *Gourielli* record herein. Certain exhibits of a voluminous nature, including Exs. 1-A through 4-D, are in the original record but not printed in the Transcript, the parties having stipulated that reference may properly be made to the original record.

While owned by petitioner Gourielli, the 1981 series bonds had the highest interest and the second farthest maturity date of all series of bonds issued pursuant to the Mortgage and Deed of Trust. Petitioners' expert witness testified that because of these facts the 1981 series would be the first bonds to have been called if the company had decided to exercise its right of call at any time that petitioners owned the bonds (R. 22, 28). However, at the date of trial, none of the outstanding First Mortgage Bonds of the Company had ever been redeemed at either the special or general price.

Pursuant to Section 125 of the Internal Revenue Code of 1939 and Treasury Reg. 118, Sec. 39.125(b)-2, petitioner Gourielli elected to amortize bond premium to the 30-day call date. Petitioner claimed on his return for 1953 a deduction of $83,056.07 as amortization of bond premium based upon the special call price of 102⅜. Respondent conceded the right to amortize to the 30-day call date but contended that an amortization deduction was proper only if based upon the general call price of 105⅜. Respondent accordingly disallowed $18,225 of the amount claimed, representing that portion of the amortization deduction equal to the difference between the general and special call prices.

The Tax Court sustained the determination of the Commissioner and the court below affirmed the decision of the Tax Court.

Jacob A. and Bertha L. Goldfarb *v.* The Commissioner of Internal Revenue (*Goldfarb* Case)

Petitioner Goldfarb purchased Arkansas Power & Light Company (hereafter called Arkansas) 4¼% 1983 Eighth Series First Mortgage Bonds at prices ranging between

109⅝ to 111, and sold them at an average price of 105⅝ as shown in the following table:

Principal Amount	Date Purchased	Date Sold	Gross Sales Price	Cost	Commission on Purchase
$200,000	11/20/53	6/16/54	$210,800	$220,000	$ 500
20,000	11/20/53	6/16/54	21,080	21,925	50
280,000	11/23/53	6/16/54	295,120	310,800	700
$500,000			$527,000	$552,725	$1,250

The purchases were made through the New York brokerage firm of Timmins & Co. The purchase price was paid in cash.

The issuance and redemption of the bonds were governed by the provisions of the Mortgage and Deed of Trust dated as of October 1, 1944 (Ex. 1-A; R. 93),[2] the Third Supplemental Indenture dated as of October 1, 1949 (Ex. 2-B; R. 93) and the Seventh Supplemental Indenture dated as of June 1, 1953 (Ex. 3-C; R. 93). Pursuant thereto, the bonds were redeemable prior to maturity at the option of Arkansas upon thirty days' call notice at either a general redemption price payable out of general funds or a special redemption price payable out of special funds. During the twelve month period ending May 31, 1954, the general redemption price was 105.36 and the special redemption price was 101.36.

Under the governing indenture provisions, cash contributions to one of the following funds could be used for redemption of Arkansas bonds of the Eighth Series at the

2. "Ex." references are to exhibits which are separately certified in the *Goldfarb* record herein. Certain exhibits of a voluminous nature, including Exs. 1-A through 4-D, are in the original record but not printed in the Transcript, the parties having stipulated that reference may properly be made to the original record.

special redemption price: Sinking or Improvement Fund; Maintenance and Replacement Fund; Eminent Domain Fund (Ex. 3-C, Sec. 1 (II); R. 93). Arkansas, where it otherwise would have been required to contribute cash to a Fund, could elect alternative options such as the certification of property additions or the waiver of its right to issue additional bonds. The indenture also provided that the bonds could be redeemed at the special price from the proceeds of released property (see Ex. 1-A, Art. XI; R. 93). Arkansas elected the available alternatives and did not make cash contributions to the Fund.

Pursuant to Section 125 of the Internal Revenue Code of 1939 and Treasury Reg. 118, Sec. 39.125(b)-2, petitioner Goldfarb elected to amortize bond premium to the 30-day call date. Petitioner Goldfarb claimed on his return for 1953 a deduction based upon amortization of bond premium to the special call price of 101.36. Respondent again conceded the right to amortize to the 30-day call date but contended that an amortization deduction was proper only if based upon the general call price of 105.36. Respondent accordingly disallowed $20,000 of the amount claimed, representing that portion of the amortization deduction equal to the difference between the general and special call prices.

The Tax Court sustained the determination of the Commissioner and the court below affirmed the decision of the Tax Court.

Summary of Argument

1. Prior to December 1, 1953, petitioners purchased fully taxable bonds at a premium above maturity value. The bonds were callable at the option of the issuer, upon 30 days notice, at either a general call price or a lower

special call price. The cost of the bonds was in excess of both call prices. Under Section 125 of the Internal Revenue Code of 1939, petitioners elected to amortize bond premium—the excess of cost over the amount payable at the special call price—during the first 30 days of ownership and deducted the full amount of such premium in the year 1953. Amortization on a 30 day basis was permitted under respondent's regulations and under the decision of this Court in *Commissioner* v. *Korell*, 339 U. S. 619 (1950). Respondent concedes that such amortization was proper to the higher general call price, but denies the propriety of amortization to the lower special call price on the theory that only the general call price and not the special call price constituted an "amount payable" on the call date within the meaning of Section 125.

Neither the statute itself nor respondent's regulations thereunder impose any limitation upon the generality of the term "amount payable" at the call date. Commencing in 1951 and throughout the period in issue here, respondent promulgated numerous uniform private letter rulings validating 30-day amortization of bond premium to the special call price.

In 1956, in a published revenue ruling (Rev. Rul. 56-398, 1956-2 Cum. Bull. 984), respondent for the first time announced a position adverse to amortization of bond premium to the special call price and thus adverse to his prior uniform rulings. Respondent seeks retroactively to apply his change of position to petitioners and others who did not request the private rulings. Respondent has announced however that his 1956 change of position does not apply retroactively to those taxpayers who did receive private rulings. Respondent does not assert any basis of differentiation between the two groups of taxpayers, other than the receipt by the first group of private rulings addressed

specifically to them. Respondent is aware that copies of his private rulings were widely circulated and were relied upon by many taxpayers who purchased callable bonds but who did not seek their own rulings. Respondent does not deny that such rulings, if requested, would unquestionably have been forthcoming.

The very question presented for decision here has previously been presented for determination to three Courts of Appeals. The Second Circuit, in the instant cases, held for respondent. The Sixth Circuit, and recently the Third Circuit, held in favor of the taxpayers.

2. It is the position of petitioners that nothing in the statutory wording of Section 125 or in the language of respondent's long standing regulations in any way restricts or limits the definition of bond premium to exclude premium computed with respect to a special call price. There is nothing rare or unrealistic in special call provisions. They are found in numerous bond indentures including indentures in use long before the enactment of Section 125. The reality of the special call provision is attested to, for example, by the fact that in the years 1954 and 1960 special calls were actually numerically *more* frequent than general calls.

3. The legislative history of Section 125 of the 1939 Code and of its successor provision, Section 171 of the 1954 Code, directly supports the propriety of amortizing bond premium to a special call price. The staff summary of the Bill which became the 1954 Code, in illustrating the workings of Section 125 of the prior law, used as its example the special call price of a then popular bond issue. Even more significant, the 1942 testimony before the Senate Finance Committee considering the adoption of Section 125 itself,

specifically and in so many words presented to Congress the question of amortizing bond premium to a lower special call price. Congress was thus aware, from the beginning, of the special call price question. Congress had the opportunity to limit the generality of Section 125 so as to make the section applicable only to the general call price. Congress enacted no such limitation.

4. In enacting Section 125, "Congress was legislating for the generality of cases". *Commissioner* v. *Korell*, 339 U. S. 619, 625 (1950). Both Section 125 and the realities of commercial life require that a determination as to the propriety of amortizing bond premium to the special call price must be made by the adoption of a general rule. Respondent seeks to deny such amortization to petitioners on the ground that, for their particular bonds and at their particular purchase dates, market conditions rendered it unlikely that a special call was then about to be made. Respondent thus seeks the adoption of a rule which would impose an intolerable burden of analysis upon the taxpayer and an equally difficult burden of administration upon respondent's own revenue agents. The likelihood or unlikelihood of redemption at the special call price is of no relevance under either the Congressional statute or respondent's regulations. If it were a relevant consideration, it would be of equal relevance in determining the propriety of amortization of bond premium to the general call price. Yet respondent has never claimed, and he does not now claim, that a likelihood of redemption is a condition precedent to amortization of bond premium to the general call price.

That Section 125 requires a rule of general applicability is affirmatively supported by a requirement which appears in both the statute and the regulations. Once an election

is made to amortize bond premium with respect to the earlier call date and price rather than to the maturity date and price, exactly the same method must be followed with respect to all other bonds then or later owned by the taxpayer. Once the taxpayer elects to amortize with respect to the special call, he must thereafter adhere to this election and amortize with respect to the special call date and price of all other bonds. His election is thus one of general application; it would be improper for the taxpayer later to claim that a special call was "unlikely" with respect to newly acquired bonds in order to defer to a more advantageous year the amortization deduction with respect to such bonds.

5a. Finally, it is the position of petitioners that respondent's own regulations, as uniformly interpreted by him in contemporaneous and well-publicized private rulings, bar respondent from retroactively changing his position to the detriment of petitioners. Regulations promulgated by respondent under Section 125 are not merely interpretive of the statute. They are legislative regulations issued pursuant to an express delegation of legislative power set out in Section 125 itself. Respondent was delegated authority to determine what was a reasonable method of amortizing bond premium, and in connection therewith, to determine the meaning of the phrase "amount payable" on the call date. Respondent's regulations are consistent with amortization to the special call price, and respondent affirmatively interpreted his regulations to permit such amortization. Respondent now believes that his position was unwise, but he cannot, merely for that reason, change his position retroactively since, under the statute, his prior decision was legislative in character. Respondent may argue in other cases that, in his regula-

tions and rulings, he has misinterpreted the will of Congress, but respondent may not argue in the instant cases that he has misinterpreted a standard which, pursuant to specific Congressional direction, he himself established. Respondent's regulations and consistent favorable rulings, in force at the time of the instant transactions, were the law. Just as Congress may not retroactively change the law—as to some taxpayers but not as to others—Congress could not and did not delegate to respondent power to do what Congress could not do.

5b. In the instant situation, it would avail respondent nothing to argue that his regulations were merely interpretative rather than legislative. The regulations as construed by respondent presented, at least from 1951, an administrative position in favor of amortization to the special call price. This administrative position was widely known and widely relied upon by taxpayers. As illustrated by the staff summary of the Bill which became the Internal Revenue Code of 1954, this administrative position was also known to Congress. Congress reenacted Section 125 of the 1939 Code as Section 171 of the 1954 Code without retroactive change. Such alterations as were made applied prospectively and only to certain bond issues, and did not distinguish as between the special and the general call prices. Under applicable law as enunciated by this Court, Congressional reenactment of the law is a bar to any retroactive change in administrative position by respondent.

5c. Section 125 contemplated the use of a reasonable method of amortization. Over many years respondent announced that amortization to the special call price was a reasonable method. It was during this period that

petitioners in the instant cases purchased their bonds and amortized premium to the special call price. What was a reasonable method for one taxpayer must have been a reasonable method for all other taxpayers holding the same or similar bonds. This is exactly the situation in the instant cases.

ARGUMENT

I

Introduction

Despite their somewhat complex factual background and the intricacy of argument which they invite, the two cases now consolidated before this Court present a simple, basic and ever-recurring problem of federal taxation. Cutting through the underbrush of specious differentiation and the morass of conflicting authority, these cases present yet another situation in which Congress, in enacting a provision of the Revenue Laws, created a loophole (a loophole which both Congress and the respondent recognized and sanctioned for many years thereafter, including the taxable year involved herein, see pp. 21-25, 31-33, *infra*). The basic issue for determination by this Court is, simply, who is the proper party to put his thumb in the dike?[3]

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3. See the opinion of Aldrich, J. in *Fabreeka Products Co.* v. *Commissioner*, 294 F. 2d 876 (1st Cir. 1961):

> "Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the Congressional thumb, not the court's."

This sentence was quoted in the opinion of the Third Circuit, rendered November 8, 1961, in *Evans* v. *Dudley*, F. 2d , (61-2 U.S.T.C. par. 9729). Both *Evans* and *Fabreeka* interpret Section 125 of the Internal Revenue Code of 1939.

The hole in the dike was created by Section 125 of the Internal Revenue Code of 1939, added to that law by Section 126(b) of the Revenue Act of 1942. The 1942 statute permitted a taxpayer to amortize bond premium to a call date in advance of maturity. The existence of the Section popularized the purchase of bonds subject to a 30-day call, since it permitted amortization of premium on such bonds over a 30-day period, thus awarding a substantial benefit to high bracket taxpayers in granting them ordinary income deduction in the amount amortized and capital gain on resale of the bonds at a price in excess of the call price. For identical reasons, provisions of the tax law permitting a deduction for accelerated depreciation have popularized the purchase of depreciable property by high bracket taxpayers. That the law then awarded such benefits to the owners of callable bonds and now continues to award them to owners of depreciable property is not questioned.

The amount of the tax benefit which attended the acquisition of a bond and utilization of the amortization provisions of Section 125 was, of course, dependent upon the extent of the spread between the higher market price and lower call price: The greater the spread, the greater the tax benefit. The most extreme cases were presented by convertible bond situations in which the conversion stock was selling at a high price, forcing a corresponding rise in the market price of the convertible bond and thus further increasing bond premium. Respondent found a loophole which included the convertible bond premium too wide for his taste and sought to close it administratively. This Court, in *Commissioner* v. *Korell*, 339 U. S. 619 (1950), observed the breadth of the statutory permission and refused to recognize respondent as the proper

party to narrow it.[4] The *Korell* decision led to *Congressional* reexamination of Section 125, and the enactment of Section 217(a) of the Revenue Act of 1950 which eliminated from the Statute amortization of bond premium attributable to a conversion feature. Thus, *Congressional* action narrowed but by no means eliminated the tax benefit inherent in Section 125.[5]

In enacting the Internal Revenue Code of 1954, Congress again reexamined the tax benefit inherent in Section 125 and the 30-day amortization permitted by that Section. In adopting Section 171 of the present Code, successor to Section 125 of the 1939 Code, Congress restricted the tax benefit but did so only prospectively—and then only for recently issued bonds. This prospective legislative enactment thus further narrowed the loophole, but again did not eliminate it.

Finally, in 1958, by adopting Section 13 of the Technical Amendments Act of 1958, 72 Stat. 1610, which withdrew

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4. Both lower courts in *Korell* pointed out that the bonds there in question were callable, and that amortization was properly taken, on a 30-day basis. 10 T. C. 1001 at 1002 (1948), 176 F. 2d 152 at 153 (2d Cir. 1949).

5. Congressional response to the *Korell* decision was specifically limited to the convertible bond situation; the enactment of Section 217(a), Revenue Act of 1950, did not relate to any other aspect of the application of Section 125. The legislation simply provided:

> "In no case shall the amount of bond premium of a convertible bond include any amount attributable to the conversion features of the bond."

The Congressional Committee Reports accompanying the 1950 Amendment, H. R. Rep. No. 2319, 81st Cong. 2d Sess. 48-49 (1950), particularly when read in conjunction with the Committee Reports accompanying the original enactment of Section 125(b), H. R. Rep. No. 2333, 77th Cong. 2d Sess. 79-81 (1942), make it perfectly clear that Congress did not view the *Korell* decision as a judicial exercise in faulty logic or as a misinterpretation of the original legislative intent. Where, as in the instant cases, a question of interpreting Section 125 is presented lying outside the scope of the 1950 Amendment, the *Korell* analysis retains its full vitality.

the preferential treatment of long-outstanding issues, Congress at last eliminated the tax-saving feature of former Section 125 in its entirety. Again, the legislative change was made prospectively only, this time from January 1, 1958.[6]

None of these Acts of Congress affects the instant cases. Taxpayers Gourielli and Goldfarb and their bonds fit nicely under Section 125 of the 1939 Code. Respondent does not contest this. But, as in the *Korell* convertible bond situation, he is unhappy about the revenue loss and seeks to minimize it by attempting to do administratively what Congress did not choose to do legislatively. In the instant cases, the bonds were callable on 30 days' notice at either a higher general call price or a lower special call price. Respondent concedes amortization, on a 30-day basis, to the higher general call price. He rejects amortization to the special call price by discovering distinctions and differences between the two prices which nowhere appear in the statute or in his regulations. In taking his revenue protective stand, the respondent has been forced to adopt three positions:

> Respondent does not recall or chooses to ignore pertinent legislative history directly supporting amortization to a special call price.
>
> Respondent finds his regulations, and his uniform contemporaneous private rulings which permitted amortization to the special call price in identical situations, to have nothing to do with the instant cases.

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6. The applicable date under the 1954 change was January 22, 1954, the date the House Ways and Means Committee announced its proposed action, and then only to bonds issued after January 22, 1951. The 1958 change was made prospective from January 1, 1958 although as originally drafted the amendment would have been effective as of November 7, 1956. See S. Rep. No. 1983, 85th Cong. 2d Sess. 22-23 (1958).

Respondent finds the decision of this Court in *Commissioner* v. *Korell* to be quite unrelated to the situation now presented for determination.

The Court of Appeals for the Second Circuit, in the instant cases, has agreed with the respondent. The Court of Appeals for the Sixth Circuit, in *Parnell* v. *United States*[7] and, more recently, the Court of Appeals for the Third Circuit, in *Evans* v. *Dudley*,[8] have decided the issue here presented in favor of the taxpayer. In line with the decisions of the Sixth and Third Circuits, and contrary to the decision of the Second Circuit, petitioners respectfully submit that the position of respondent is without merit. Congress, in enacting Section 125, created a tax benefit. Congress was aware of the magnitude of the tax benefit, including the advantage of amortizing bond premium to a special call price. Congress, on various occasions, chose to narrow this loophole, prospectively only, and ultimately Congress chose to close it, again prospectively only. During 1953, the year in question here, respondent was fully aware of the benefits inherent in amortization of bond premium to a special call price. Respondent chose to rule uniformly in favor of amortization to the special call price. Respondent now seeks to disregard his own contemporaneous construction and to disregard the Congressional decision to act only prospectively. Respondent has determined, notwithstanding his own past position and the clear and informed decision of Congress not to act retroactively, that he, respondent, may step in retroactively and put his thumb in the dike.

7. 272 F. 2d 943 (6th Cir. 959), *affirming* 58-2 U.S.T.C. par. 9881 (memorandum of decision), 187 F. Supp. 576 (M. D. Tenn. 1959) (findings and conclusions).

8. F. 2d , 61-2 U.S.T.C. para. 9729 (3d Cir. 1961).

Respondent seeks to arrogate to himself authority which is not his. This Court should reject the position of respondent and leave to Congress the authority which only Congress may properly exercise.

II

The specific issue presented is whether the term "bond premium" contained in Section 125 of the 1939 Code and applicable Treasury regulations, has reference only to a higher general call price or encompasses a lower special call price as well.

Section 125 of the Internal Revenue Code of 1939 and applicable Treasury regulations, in providing for amortization of bond premium, broadly define that term as simply the difference between the cost of the bond and the amount payable at maturity or earlier call date. In the instant cases there is no question as to the cost of the bonds. Nor would there seem to be any question that the "earlier call date" was 30 days from the purchase date, since the bonds were callable on 30 days' notice. This Court has previously, in *Commissioner* v. *Korell*,[9] approved 30-day amortization and respondent himself, in the instant cases, has permitted such amortization to the *general* call price.

Issue has been joined on the meaning of the phrase "the amount payable on * * * earlier call date." It is respondent's position that market conditions made it unlikely that the bond issuers would call bonds at the lower special call price at the time these bonds were purchased by the petitioners, and respondent therefore contends that

9. 339 U. S. 619 (1950).

the "amount payable" on the call date cannot include the amount payable at the special call price.

It is the position of petitioners that there is nothing in the statutory or regulatory definition which in any way limits or restricts the meaning of the term "amount payable" or renders the meaning of that term in any way dependent upon the presence or absence of market conditions which would make redemption at the special call price particularly likely or unlikely. It is obvious that, just as prevailing market conditions may at times render redemption at the special call price unlikely, prevailing market conditions may also render redemption at the higher general call price at least equally unlikely. Yet respondent has never contended, and he does not now contend, that considerations of the market should affect the statutory words "amount payable" where a general call price is involved.

Respondent would find another string in his bow. A general call may be made out of funds generally available to the bond issuer. A special call may be made only out of such funds as are specified in the particular bond indenture. Respondent is aware that the two call provisions, general and special, serve quite different but equally legitimate functions; he does not contend that the general call price is "real" or "true" and that the special call price is merely a sham.[10] Respondent is equally aware that many, if not most, bond issues which have been called in

10. With respect to the difference between the two call prices, the Court of Appeals for the Third Circuit in *Evans* v. *Dudley*, decided November 8, 1961, F. 2d , 61-2 U.S.T.C. para. 9729, stated:

> "* * * [A] general call is one which a corporation employs when it finds that the current rate of interest on bonds is substantially less than what it is paying on an outstanding issue. If there is a provision in the bond permitting it to be called, the debtor may call it and refinance his obligations at a lower

recent years, have been called at the special call price rather than at the general call price.[11] Nonetheless, despite this unfortunate intrusion of the facts, respondent would have this Court hold that the unqualified statutory language "amount payable * * * on earlier call date" must, if a special call has not actually been made,[12] be

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interest rate. Of course, the general call price must be high enough to compensate the lender for the loss of his now-profitable investment. On the other hand, a special call is one by which, subject to the terms of the original contract, bonds may be called and paid for out of special funds set up by the terms of the indenture and to which the debtor is obligated to make periodic payments. A typical example would be a sinking fund to which the debtor each year makes a stipulated payment. A purchaser, when he buys bonds on the market, does not know whether his bonds will be called at all before maturity or, if they are, whether it will be at the special or the general call price."

See also finding of fact 2 in *Parnell v. United States*, 187 F. Supp. 576 (M. D. Tenn. 1959) (R. 39-40).

11. See *Evans* v. *Dudley*, F. 2d , 61-2 U.S.T.C. para. 9729 (3d Cir. 1961):

"An examination of Standard and Poor's *Bond Guide* for 1954 and 1960 shows that in those years special calls were numerically more frequent than general calls and that a substantial dollar amount of bonds was called specially in both years."

12. In 1956, by Rev. Rul. 56-398, 1956-2 Cum. Bull. 984, respondent—reversing the position he had previously and uniformly taken in a series of private rulings—for the first time announced that amortization of bond premium under Section 125 of the 1939 Code was to be limited to premium in excess of a general call price and could not include premium in excess of a lower special call price, except

"* * * [I]f an actual notice of call at the 'special' redemption price on a specific or ascertainable date has been issued with respect to any particular bond or bonds, or portion thereof, the amortizable bond premium thereon may be computed with reference to their 'special' redemption price. This will timely permit ample amortizable bond premium deductions in accordance with the intent of section 125, *supra*, and the regulations thereunder." 1956-2 Cum. Bull. 984 at 987.

qualified in some mysterious way to eliminate reference to the amount payable on that date at the legitimate special call price.

This Court must determine whether the generality of the statutory definition of the term "bond premium" as set forth in Section 125 is to prevail—a definition which contains not the slightest hint of the limitation contended for by respondent—or whether respondent, when it suits his purpose, may qualify the text of the statute by importing into it a shifting and uncertain standard of "likelihood of redemption."

III

The legislative history of Section 125 of the Internal Revenue Code of 1939 and of its successor, Section 171 of the Internal Revenue Code of 1954, affirmatively supports amortization of bond premium to the special call price.

The instant cases are governed by Section 125 of the Internal Revenue Code of 1939. The tax benefits inherent in Section 125, providing for amortization of bond premium, were narrowed, prospectively only, in the reenactment of that provision as Section 171 of the Internal Revenue Code of 1954. The Congressional Committee Reports which accompanied Section 171 clearly state the Congressional understanding of the tax benefit which was inherent in the prior law applicable to the instant cases:

> "Amortization of premium on callable bonds (sec. 171)
>
> "Under existing law, a bond premium may be amortized with reference to the amount payable on maturity or on earlier call date, at the election of the taxpayer. *In the case of bonds with a very short call feature, such as those providing for call at any*

time on 30-day notice, the entire premium may be deducted in the year of purchase.

"This provision has given rise to tax-avoidance opportunities. Substantial bond issues have been made subject to a 30-day call, permitting the purchaser to take an immediate deduction for the entire premium against ordinary income. *Where the call feature is nominal or inoperative, this permits a deduction for an unreal loss,* since the market value of the bonds ordinarily remains fairly stable over considerable periods. The bonds may then be resold after 6 months subject to long-term capital gain treatment. The write-off of premium thus affords a gratuitous tax saving, equivalent to the conversion of a corresponding amount of ordinary income into capital gain. This process may be repeated indefinitely.

"To curb this type of abuse, your committee's bill provides that the premium on callable bonds may be amortized to the nearest call date only if such date is more than 3 years from the date of original issue of the securities. *This provision will apply only to bonds issued after January 22, 1951, and acquired after January 22, 1954.*

"The January 22, 1954, date corresponds to the date of announcement of this action by your committee. *This effective date limitation,* together with the exemption of bonds issued prior to the 3 preceeding years, *will prevent unfair retroactive application of the provision to previous investors* or long outstanding issues. The proposal is also confined to bonds having a call date within 3 years from the original date of issue, in order to avoid disturbing market effects on issues having an original long-call date as they approach or come within the 3-year period prior to possible call." (Emphasis supplied).[13]

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13. H. R. Rep. No. 1337, 83d Cong. 2d Sess. 26-27 (1954). The report of the Senate Finance Committee is in accord. See S. Rep. No. 1622, 83d Cong. 2d Sess. 30-31 (1954).

Despite the clarity and persuasiveness of the quoted language, the Court of Appeals for the Second Circuit in the instant cases was of the opinion that the 1954 legislative history did not show that Congress had in mind amortization to the highly beneficial special call price.

Unfortunately, the Court of Appeals, as the Tax Court in the instant cases, failed to consider the summary of H. R. 8300 (the Bill which became the Internal Revenue Code of 1954) prepared by the staff of the Joint Committee on Internal Revenue Taxation, the relevant portion of which appears at page 21 of Part I (April 7 and 8, 1954) of the Hearings Before the Committee on Finance, United States Senate, 83rd Congress, Second Session. The following is the staff's summary prepared for the specific purpose of illustrating the workings of Section 125 of the Internal Revenue Code of 1939:

> "Under existing law, a bond premium may be amortized, at the election of the taxpayer, over the remaining life of the bond or to the earliest call date, whether or not the bond is actually called. This has given rise to the following type of case, *which is illustrated by using recent figures of an actual bond issue.* The bond sold at a price of 120. It was a 30-year bond with interest of 3.75 percent and callable on 30 days notice at 102. The circumstances made an actual call very unlikely. A buyer of the bond could, therefore, purchase the bond at 120, hold it for the 6 months and sell it again at approximately 120. During this period, he would have a premium of 18 points, the difference between the market price and the call price, which under existing law he could write off in 30 days as an ordinary deduction. The amortization reduces the basis of the bond to 102. The buyer, therefore, pays a capital gains tax on a 'gain' of 18 and gets a deduction

> of 18 against ordinary income. At a price of 120 the interest return on this bond is approximately 2½ per cent, which is far below a government 30-year bond." (Emphasis supplied.)

The actual bond issue to which the staff summary referred was, on the figures given, unquestionably an issue of Appalachian Electric Power Company bonds. These bonds were a very popular investment vehicle at the time. *The general call price of Appalachian bonds was then 105⅜, and the 102 call price specified in the staff summary was the* special *call price of these bonds.*[14]

Further, and even more significant, is the legislative history of the 1942 enactment of Section 125 itself. A principal witness before the Congressional Committees which considered Section 125 was Mr. Roy C. Osgood, Vice President of the First National Bank of Chicago and a member of the Committee of Federal Finance of the United States Chamber of Commerce. In testifying before the Senate Finance Committee, Mr. Osgood, who adopted a position adverse to the enactment of Section 125, cited the Committee to the then outstanding issue of Armour & Company 1st Series, 4 percent bonds due August 1, 1955. Mr. Osgood pointed out that the bonds were then trading on the New York Stock Exchange at 106 and were redeemable at both a "general" and a "special" call price: upon 60 days notice as a whole at 105, and for the sinking fund on any interest date upon 30 days notice at 102½. Mr. Osgood then specifically raised for Congress the question of which call price the bondholder could elect amortization

14. In point of fact, Appalachian bonds at the date of the staff summary had a special call price which was a fraction of a point *higher* than the 102 call price given in the staff summary. The ignoring of the fraction by the staff was obviously a matter of convenience in preparing its written presentation.

to under the proposed law, the general 105 or the special 102½.[15]

It is thus perfectly clear that Congress, in initially enacting Section 125, *was* specifically aware that bonds often have two quite different call prices. Congress most definitely had the opportunity to consider enacting a statute which limited amortization of bond premium to only the higher generally available "general" call price. Despite this Congressional awareness and the opportunity initially to limit the right of amortization, Congress did not choose to insert any such limitation into the law. In point of fact, Congress *never* chose to distinguish between the general and special call price, although in reenacting Section 125 of the 1939 Code as Section 171 of the 1954 Code the issue was again brought to the attention of Congress through the staff summary of H. R. 8300. When Congress chose to narrow the right of amortization in 1954, and to eliminate that right in 1958, Congress did not differentiate between general and special call price provisions.

From the beginning, Congress understood the words of Section 125, "amount payable" on call date, to mean exactly that and nothing else. From the beginning, where a bond issue provided for special call, an informed Congress clearly sanctioned amortization of bond premium to that special call price.

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15. Vol. 2, Hearings Before Committee on Finance, U. S. Senate, 77th Cong. 2d Sess. H. R. 7378, p. 1729. The testimony of Mr. Osgood was not adverted to either by the Tax Court or by the court of appeals in the instant cases below.

IV

The special call price amortization problem presented in the instant cases can be settled properly and effectively only by the adoption of a general rule.

This Court has once before had occasion to consider Section 125 of the Internal Revenue Code of 1939. In the course of that consideration, the Court stated that "Congress was legislating for the generality of cases". *Commissioner* v. *Korell,* 339 U. S. 619, 625 (1950).

This observation is no less pertinent today. It fully supports the recent decision in *Evans* v. *Dudley,* F. 2d , 61-2 U. S. T. C. para. 9729 (3d Cir. 1961), in which amortization of bond premium to the special call price was approved with the following observation:

> "We think, first of all, that this question should be settled by a general rule applicable to the cases as and when they come up. We think it would be hard on the taxpayer, as well as a difficult problem of administration, to go into the question of whether in any particular case there is a probability of a call of the bonds involved, whether the funds out of which a special call is to be made are sufficient, whether the price of the bonds has dropped low enough so the debtor is buying its own bonds on the market and retiring them in that manner, and so on and so on. We think both Government and taxpayer will be better off with a general rule."

This quotation from the opinion of Judge Goodrich states to perfection the position of petitioners in the instant cases. To require otherwise, as the Court of Appeals for the Second Circuit in the instant cases seemingly would do, and force an examination of each separate

bond issue and of each separate bond issuer to determine the likelihood of redemption in a month or a year or 10 years, at one price or at another, is to inflict an intolerable burden of investigation, analysis and decision upon the taxpayer and upon the revenue agent auditing the taxpayer's return.[16]

In *Commissioner* v. *Korell*, this Court, applying the principle of "the generality of cases", resolved affirmatively the question of whether the term "bond premium" in Section 125 included the full difference between the 30-day call price of a convertible bond and its higher cost, where at least part of that cost was attributable to the bond's conversion feature. The Commissioner's argument, which this Court there rejected as having no basis in the law, was that "bond premium" must be limited to include only "true" bond premium and that accordingly each bond issue must be separately analyzed to determine how much premium is "true". In the instant cases the court of appeals attempted to distinguish *Korell* on two grounds. First, the court indulged in the semantic distinction of substituting "realistic" for "true". Second, it suggested that in *Korell*, this Court was dealing with the "minuend" (cost) whereas the instant problem relates to the "subtrahend" (amount payable at the call date).[17] Petitioners respectfully submit that these distinctions are

16. The Second Circuit, below, suggested the possibility that a taxpayer might first deduct the premium over the general call price, and later (depending upon "circumstances indicating the likelihood of a substantial call") deduct the difference between the two call prices (289 F. 2d 74-75, R. 148-149). But Congress delegated the power to prescribe reasonable methods of bond amortization to the Commissioner of Internal Revenue with the approval of the Secretary, and the Treasury regulation actually issued is inconsistent with the method suggested by the Second Circuit.

17. 289 F. 2d 69, 76; R. 150.

without merit. Section 125 contemplated a determination of "bond premium", and both in *Korell* and here a significant issue was and is the choice between a workable rule of general applicability and the adoption of what, in the instant situation, would be a virtually impossible requirement of analyzing each bond issue and each bond issuer in light of current market conditions in order to guess which figures are to go into the computation of the bond premium of the day.

That Section 125 contemplated a rule of general applicability in the determination of amortizable bond premium is supported both by the decision of this Court in *Commissioner* v. *Korell* and by the dictates of common sense. It is also supported by the statute itself and by respondent's regulations.

Both the statute, Section 125 (e) (2), and the regulatory provisions, Reg. 118, §39.125 (b)-2, §39.125 (e)-1, require that once an election is made to amortize bond premium with reference to an earlier call date and price, rather than to the maturity date and price, exactly the same method must be followed with respect to all other bonds then or later held. Thus, if amortizable bond premium is once determined with reference to the special call price of any bonds, it must thereafter be determined with reference to the special call price of all other bonds.

Since a consistent method must be followed, it is irrelevant to consider, as did the court of appeals in the instant cases, the degree of likelihood, at the time when the taxpayer "first elected a method of amortization" (287 F. 2d 69, 74; R. 148), that the particular bonds will be called at the special call price either within the supposedly foreseeable period of ownership by the purchaser or "during the period for which the amortization is being taken and

the deduction claimed" (289 F. 2d 69, 74; R. 147)—the court having apparently been uncertain which of the two periods should be selected by the revenue agent who makes the initial determination. Contrary to the impression of the Second Circuit, what is relevant is not the likelihood of a special call within the next 30 days, but rather the statutory and regulatory requirement that the taxpayer's election be one of general applicability.

The only way that the principle of "generality of the cases" and the consistent method of amortization required by the statute and the regulation can be harmonized would be if the amount payable at the special call price could never properly be used. Neither the respondent nor the Court of Appeals for the Second Circuit have at any time suggested the adoption of such an absolute prohibition.

V

Respondent's attempt to change retroactively a position favorable to the taxpayer as announced in pertinent regulations and uniform contemporaneous rulings may not be sanctioned.

In the instant cases, petitioners purchased the bonds which are here in issue in the year 1953.

Respondent's position with regard to amortization of bond premium was first announced by regulations promulgated in 1943 by T. D. 5224, 1943-4-11348, Reg. 103, Section 19.125-5. The pertinent regulatory language, retained unchanged in all subsequent regulations issued prior to the Technical Amendments Act of 1958, including Reg. Section 1.171-2 issued under the 1954 Code, was as follows:

> "• • • the amount due on such date [the earlier call date] will be considered as the amount pay-

> able [unless the taxpayer has regularly employed a different method of amortization]. Hence, the bond premium on such a bond is required to be spread over the period from the date as of which the basis for loss of the bond is established down to the earlier call date, rather than the maturity date. The earlier call date may be the earliest call date specified in the bond as a date certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer." Reg. 118, Section 39.125(b)-2(a)(1953).

This regulatory language, as was pointed out in *Pacific Affiliate, Inc.*, 18 T. C. 1175, 1208 (1952), follows the language in Report No. 1631 of the Senate Finance Committee, 77th Cong., 2d Sess., p. 92, which read in part (at p. 94):

> "The fact that a bond is callable * * * does not of itself prevent the application of this Section. In the case of a callable bond, the *earliest* call date will, for the purposes of this Section, be considered as the maturity date. Hence the *total premium* is required to be spread over the period from the date as of which the basis of the bond is established down to the *earliest* call date, rather than down to the maturity date." (Emphasis supplied.)[18]

It is undisputed that respondent, when he adopted and subsequently readopted the quoted regulation, knew full

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18. In footnote 8 to its opinion (289 F. 2d 69, 76; R. 150) the Second Circuit, below, cited S. Rep. No. 2375, 81st Cong., 2d Sess. p. 3101 (1950) but failed to consider the material from S. Rep. No. 1631 quoted in *Pacific Affiliate, Inc.* Nor did the court consider the Staff Summary of H. R. 8300 or the 1942 testimony of Roy C. Osgood before the Senate Finance Committee, which material is discussed in Part III of this Brief. See p. 24, *supra*.

well that many bond issues—public utility bonds, industrial bonds, and revenue bonds of governmental agencies—provide for both special and general calls. Respondent was equally aware that in some issues the two prices are available on the same call date, while in others the different call prices are available on different dates. Thus, if the special call price is available on the earliest call date, the respondent's own regulation requires that amortizable bond premium be computed with reference to such call price (unless the taxpayer selects and regularly employs an alternative method). Where the two call prices are available on the same date, it must follow that the taxpayer, under the cited regulation, is entitled to select and must adhere to the selection of either one or the other.

If respondent's only pronouncement with regard to bond premium amortization had been the cited regulation, petitioners would be content to point out that the language of the regulation requires the foregoing result. However, respondent has himself put the matter beyond dispute by his contemporaneous interpretation of his own regulations.

A special ruling issued by respondent and dated December 4, 1953 was published both by Commerce Clearing House (1954 Standard Federal Tax Reports para. 6209), and Prentice-Hall (1954 Federal Income Taxes para. 76,492), relating to tax-exempt bonds issued by the Elizabeth River Tunnel Commission. With respect to tax-exempt bonds, amortization of bond premium is important only as it affects adjustment to basis. The special call price of these bonds was available on any interest payment date after January 31, 1953 upon 30 days' notice, while the general call price was available on any interest payment date only after January 31, 1955. The bonds in question were purchased by the taxpayer in October, 1953, during the taxpayer's fiscal year ending August 31, 1954.

Respondent ruled "that the full amount of the premium paid on your purchase may be amortized, through a reduction of the basis of the bonds, during your taxable year ending August 31, 1954." Thus respondent ruled that amortizable bond premium was to be computed with reference to the special call price, since that was the only call price available prior to 1955.

While rulings with respect to fully taxable bonds were not officially published, respondent does not dispute that a substantial number of private written rulings were issued to various taxpayers stating that "*a* taxpayer" (not merely the particular taxpayer) could properly amortize bond premium to the special call price. Examples of such rulings are printed in the record herein (R. 51-65).[19] Commencing in 1951, respondent issued numerous and uniform rulings over a period of years validating amortization of bond premium to the special call price.

In 1956, however, respondent changed his mind and, by Rev. Rul. 56-398, 1956-2 Cum. Bull. 984, announced that amortization of bond premium to a special call price would not be permitted under Section 125. Respondent sought to apply his 1956 ruling retroactively to all taxpayers other than those who had previously obtained private rulings. To those taxpayers the 1956 pronouncement was to apply prospectively only (R. 54-55, 61-62, 65).

It is the position of petitioners in the instant cases that respondent's 1956 ruling cannot properly be applied to

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19. Petitioners note that the rulings printed in the record referred to, among other issues, Appalachian Electric Power Company 3¼ percent Bonds, due 1981. In these bonds the call date was not a date certain, or an interest payment date, but *any* date after 30 days' notice, as was also true of the bonds involved in *Korell* v. *Commissioner*, 10 T. C. 1001 (1948), *aff'd.*, 176 F. 2d 152 (2d Cir. 1949), *aff'd*, 339 U. S. 619 (1950) and of the bonds in the instant cases.

their amortization of bond premium in 1953. Petitioners contend that there is no ambiguity in the language of respondent's 1953 regulations, and that such regulations clearly permitted amortization of bond premium to the special call price. Petitioners further contend that to the extent the regulations were susceptible of interpretation, respondent himself made a contemporaneous interpretation by means of his uniform private rulings. These rulings stated that amortization to the special call price was proper. There is no question that respondent had the power to interpret his own regulations. *Norwegian Nitrogen Co.* v. *United States*, 288 U. S. 294, 325 (1933); *Bowles* v. *Seminole Rock Co.*, 325 U. S. 410, 414 (1945). The original and contemporaneous interpretation of a regulation by the department which issued that regulation is certainly entitled to at least as much weight as is given to the contemporaneous interpretation by Congress of a statute which it enacts.

When respondent issued his numerous, uniform and favorable rulings, he was *at the very least* announcing what he understood his own regulations to mean. In view of the legislative character of these regulations and further in view of the Congressional reenactment of the statute as so construed, petitioners submit that their construction as permitting amortization to the special call price is properly determinative of the issue presented herein.

A.

Since the pertinent regulations under Section 125 were legislative in character, rather than merely interpretative, their contemporaneous construction by respondent as validating amortization to the special call price is determinative of the issue presented herein.

The Treasury regulations applicable to the instant cases are Reg. 118, Section 39.125 (b) (1953). In their essential character, these pertinent regulations are more than merely interpretive; they are legislative regulations issued pursuant to a specific Congressional delegation of legislative power set out in Section 125 itself.

Interpretative regulations comment upon and construe the Congressional text. Under the 1939 Code, such regulations were issued pursuant to Section 62 which authorized and directed the Commissioner, with the approval of the Secretary of the Treasury, to "prescribe and publish all needful rules and regulations for the enforcement of this chapter". Legislative regulations, on the other hand, are of a rarer sort and are issued by the Treasury only pursuant to an express delegation of legislative authority contained in a particular provision of the Code. The latter situation, one in which Congress has delegated to the Executive Branch what is effectively a power to legislate in a confined area, is presented in the instant cases. See, generally, Alvord, *Treasury Regulation and the Wilshire Oil Case*, 40 Col. L. Rev. 252 (1940).

The express delegation of legislative authority is contained in Section 125 (b) (3):

> "The determination required under paragraphs (1) and (2) shall be made—
>
> • • • • •

> (B) * * * in accordance with regulations prescribing reasonable methods of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary".

The determination required under paragraph (1) is the determination of "the amount of bond premium", which paragraph (1) states "shall be determined with reference to [cost] * * * and with reference the amount payable on maturity or earlier call date". Thus Congress, in Section 125, specifically delegated to respondent legislative authority to determine "the amount payable on * * * earlier call date", which amount, when deducted from cost, establishes the amortizable bond premium.[20]

In first enacting Section 125 in the year 1942, Congress delegated limited legislative authority to respondent, and respondent exercised this authority in his 1943 regulations. These regulations remained substantially unchanged for 15 years. Commencing at least with the 1951 special ruling directed to tax-exempt bonds issued by the Elizabeth River Tunnel Commission, and continuing for some years thereafter (inclusive of 1953, the year in issue here), respondent issued numerous private rulings uniformly validating amortization of bond premium to a special call price. Respondent did not announce a change of heart until 1956, long after the transactions involved in the instant cases.

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20. Section 125(b)(3), in stating how the determination of bond premium and amortizable bond premium shall be made, actually specified two alternatives. One is clause (B), the above described legislative delegation of authority to respondent. The other, clause (A), permits the determination to be made

> "in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable".

Obviously, what is a reasonable method under clause (B) as prescribed by the Commissioner, cannot be any less a reasonable method when utilized by the taxpayer under the clause (A).

Respondent tells us he is entitled to make mistakes, that he is not required to be right the first time, and that when he has misinterpreted the will of Congress he may correct his error retroactively.[21] Whatever the validity of respondent's position may be in other situations, in the instant cases it cannot be sustained. Respondent can argue that he has misinterpreted the intent of Congress, but respondent cannot argue that he has misinterpreted himself. This is a legislative regulation, not an interpretative one. In ruling uniformly that amortization of bond premium was proper to the special call price, respondent was not interpreting the statute or interpreting regulations which interpreted the statute; respondent was interpreting his own "legislative" pronouncement—he was interpreting himself. For respondent to now argue that he *mis*interpreted himself is ridiculous.

The instant situation is thus directly analogous to one in which Congress, in enacting a provision of the revenue law, has specifically in applicable Congressional Committee Reports given an example of the effect of the provision in a particular situation. An argument that Congress itself could do. The 1956 determination of Congress did not mean what it said would be inconceivable. If Congress should thereafter attempt retroactively to change the law as to some taxpayers, but not as to others, the unjustifiable discrimination and, indeed, the denial of due process, would be patent. Congress, in delegating legislative authority to respondent under Section 125, could not delegate a power to do anything more than respondent to retroactively reinterpret his own legislative

21. This statement of respondent's position is taken from his brief in the Court of Appeals for the Second Circuit, page 22, in the *Goldfarb* case.

regulations as to some taxpayers, but not as to others, cannot be sustained.

That we are not dealing here with a novel question is illustrated by the decision of this Court in *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Railway Co.*, 284 U. S. 370 (1932). The Interstate Commerce Commission had exercised a delegated legislative function in establishing a maximum reasonable freight rate. Subsequently the Commission attempted to retroactively repeal its determination of what was a reasonable rate in order to award reparation to a shipper. This Court rejected the attempt to act retroactively:

> "The Commission's error arose from a failure to recognize that when it prescribed a maximum reasonable rate for the future it was performing a legislative function, and that when it was sitting to award reparation it was sitting for a purpose judicial in its nature. In the second capacity, while not bound by the rule of *res judicata*, it was bound to recognize the validity of the rule of conduct prescribed by it and not to repeal its own enactment with retroactive effect. It could repeal the order as it affected future action, and substitute a new rule of conduct as often as occasion might require, but this was obviously the limit of its power, as of that of the legislature itself." 284 U. S. 370 at 389.

It is worthy of note that the I. C. C. based its attempt at retroactive action upon a finding that the earlier rate had been declared upon an incomplete record and that a newer and more comprehensive record clearly indicated that the prior rate had in fact been unreasonable. In the instant cases, respondent does not allege new evidence; he has simply changed his mind. If the I. C. C. in *Arizona Grocery* could not retroactively redetermine reasonableness on the basis of newly adduced information, *a fortiori* respondent in the instant cases may not retroactively redetermine reasonableness based upon only his change of heart.

B.

Even if respondent's regulations had been merely interpretative of the statute rather than legislative, Congressional reenactment of the statute would bar retroactive change in the administrative position.

Even if respondent attempts to maintain that his regulations under Section 125 were intended merely to interpret the statutory provision and did not represent an exercise of a delegated legislative function, the argument, when applied to the instant situation, must fall short of the mark. Respondent first promulgated regulations in 1943, and adhered to them with virtually no change for 15 years.

Both before and after the transactions which were effected by petitioners in 1953, respondent interpreted his regulations in a manner uniformly consistent with petitioners' position in the instant cases.

During the period the regulations were in force, Congress, in 1950, amended a single provision of the statute and, four years later, reenacted the statute in adopting the 1954 Code. As previously noted, Congress was well aware of the contemporaneous administrative view declared in applicable regulations and uniform private rulings, that Section 125 permitted amortization of bond premium to a special call price. In neither 1950 nor 1954 did Congress in any way alter the effect of the law as regards petitioners and other taxpayers similarly situated. Under the circumstances, the law is plain that respondent's regulations, as consistently interpreted by respondent, were binding upon him until changed *prospectively. Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110 (1939); *Provost* v. *United States*, 269 U. S. 443, 458 (1926); *Helvering* v. *Griffiths*, 318 U. S. 371, 402 (1943); *Boehm* v. *Commissioner*, 326 U. S. 287 (1945); *Crane* v. *Commissioner*, 331 U. S. 1, 8 (1947); *United States* v. *Leslie Salt Co.*, 350 U. S. 383 (1956).

Petitioners recognize respondent may argue that the instant situation differs from that considered in the *Reynolds* and other cited cases in that the instant situation involves the law as construed by private letter rulings while the cited cases involved officially published Treasury pronouncements. Petitioners are aware of the obvious distinctions between a published regulation and private rulings, but submit that such distinctions are not significant for purposes of the instant cases.

First, it is the position of petitioners that Section 125 and the regulations promulgated thereunder, had there been

no contemporaneous private rulings, would in any event require a determination in favor of amortization of bond premium to a special call price. Neither the regulations nor the underlying statute contain any limitation upon the significant words "amount payable". When respondent last attempted to read a limitation into the specific wording of this law, he was unsuccessful.[22] Nothing in the passage of time has added force to respondent's argument.

Second, if the regulatory language was susceptible of interpretation, favorable interpretation was contemporaneously supplied by respondent's uniform private letter rulings. Respondent clearly had the power to interpret his own regulations, *Norwegian Nitrogen Co.* v. *United States*, 288 U. S. 294, 325 (1933). To the extent his private rulings lent color to the regulations, the situation is still one of retroactive change in the meaning of a regulation and thus cannot be excluded from the *Reynolds* rule.

Third, even taking the rulings quite apart from respondent's regulations, in the instant situation—as regards the "prospective only" principle enunciated in *Reynolds*—these rulings cannot validly be distinguished from a specific equivalent position in the regulations, for the following reasons:

1. A large number of such rulings were issued with respect to the present type of case.[23] In other words, this is not a situation in which a single minor official of the Internal Revenue Service, gave a snap judgment opinion as to the position of the government in response to an offhand question. Rather, this is a case in which

22. *Commissioner* v. *Korell*, 339 U. S. 619 (1950).

23. See, *e.g.*, the discussion in *Fabreeka Products Company*, 34 T. C. 290 at 293-294 (1960), *rev'd*, 294 F. 2d 876 (1st Cir. 1961).

persons in high positions in the national office of the Internal Revenue Service stated *frequently* in writing the respondent's position as to the effect of the law in response to formal requests for such ruling submitted in accordance with the Treasury's regulations.

2. The rulings were issued continually over a period of many years.

3. The rulings were widely publicized.[23]

4. Many purchasers of bonds having both a general and a special call price were shown copies of one or more rulings upon which, in making purchases, they relied.[23] In fact it is unrealistic to suppose that a taxpayer who was not a lawyer specializing in tax law would have greater respect for (or even access to) a Treasury regulation than he would for a letter signed by or for the nation's chief tax officer and covering explicitly the exact problem involved in the purchase he was about to make.

5. Congress was as fully aware of the administrative position as it would have been had such position been embodied in a Treasury regulation.[24]

Under the circumstances, the respondent's rulings were at least as effective in evidencing his position and in inducing reliance thereon as a specific Treasury regulation would have been. In *Connecticut Railway & Lighting Co. v. United States*, 135 Ct. Cl. 650, 142 F. Supp. 907 (1956), the Court of Claims gave effect to an administrative practice of the Internal Revenue Service publicized only in a brief filed by the government in a case before this Court. There the Court of Claims aptly referred to such administrative practice as "the law in action."

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24. See the discussion, pp. 21-24, *supra*.

The Court of Appeals for the Ninth Circuit, in a decision involving the National Labor Relations Board, gave effect to a well-known policy of that agency, although it had not previously been applied to the particular litigant. See *NRLB* v. *Guy F. Atkinson Co.*, 195 F. 2d 141, 149 (9th Cir. 1952) where the court stated:

> "The prior policy of not assuming jurisdiction in matters affecting the construction industry was to (sic) fixed and so notorious that we cannot perceive that respondent was any less taken by surprise than it would have been had the prior ruling occurred in a matter concerning this very respondent."

The fact that respondent's rulings in the area were not printed in the Internal Revenue Bulletin does not militate against their efficacy as official statements of the government's position. A determination not to print a ruling in the Internal Revenue Bulletin does not mean that the Internal Revenue Service is in doubt about the legal principles involved or that the ruling does not represent the official position of the Service. Rev. Rul. 2, 1953-1 Cum. Bull. 484, as modified by Rev. Rul. 212, 1953-2 Cum. Bull. 449, as modified by Rev. Proc. 55-1, 1955-2 Cum. Bull. 897. In fact, one of the classes of rulings not reproduced in the Internal Revenue Bulletin includes those which are considered to involve questions specifically and clearly covered by statute or regulations. See Rev. Rul. 2, *supra*, para. 4(a). Presumably the failure of the Internal Revenue Service to print its numerous and uniform pre-1956 rulings in the Internal Revenue Bulletin was attributable to the fact that someone in authority believed the position of the government to be clearly in accord with the applicable statute and regulations.

Petitioners would further note that there is a second and separate situation in which this Court has indicated it would be improper for respondent to retroactively revoke a ruling. In *Automobile Club* v. *Commissioner*, 353 U. S. 180 (1957), this Court approved retroactive reversal of a ruling to a particular automobile club where it was shown that all automobile clubs were being treated in the same manner pursuant to a *previously* published ruling of general application. The private ruling was revoked only with respect to the years *following* the publication of the generally applicable published ruling. This retroactive action by respondent was held not to have been an abuse of his discretion under Section 3791 (b) of the Internal Revenue Code of 1939[25] (now Section 7805 (b) of the Internal Revenue Code of 1954[26]) to prescribe the extent to which a ruling should be applied with retroactive effect. This Court made it clear, however, that respondent's determination was approved only because his retroactive action did not lead to inequitable results. This Court there indicated that retroactive action which did cause an inequitable result would be disapproved.

In the instant situation, the inequity is clear and undeniable. Respondent seeks to deny a deduction for amortization of bond premium to a special call price for tax years prior to his 1956 public change in position. Even more important, respondent would apply his 1956 ruling retroactively only to those taxpayers who had not obtained their own private rulings—rulings which concededly would have been forthcoming. It is therefore respectfully submitted that the decision of this Court in *Automobile Club* directly supports the position of petitioners herein.

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25. 53 Stat. 467 (1939), 26 U. S. C. A. (I. R. C. 1939) §3791(b).
26. 68A Stat. 917 (1954), 26 U. S. C. §7805(b).

Finally, petitioners would call the attention of this Court to the concurring opinion of Justice Frankfurter in *United States* v. *Kaiser*, 363 U. S. 299, 308 (1960). Over a period of many years, respondent, in a series of published rulings, had taken an administrative position with regard to "subsistence relief". Petitioner argued that respondent's administrative position had been to uniformly exempt such payments from taxation, and that an overriding principle of equal tax treatment required respondent to adhere to this long standing administrative position. Justice Frankfurter rejected the taxpayer's argument on the ground that respondent's prior rulings did not in fact present a uniform administrative position on the question presented in *Kaiser*. In finding against the taxpayer, however, the Justice clearly indicated that, had the facts supported the taxpayer's contention, the principle of equal tax treatment would have been applicable:

> "The Commissioner cannot tax one and not tax another without some rational basis for the difference. And so, assuming the correctness of the principle of 'equality', it can be an independent ground of decision that the Commissioner has been inconsistent, without much concern for whether we should hold as an original matter that the position the Commissioner now seeks to sustain is wrong."

Justice Frankfurter then submitted that the proper test is, "Is there any rational basis for the prior rulings which does not apply to the present case?" It is perfectly clear that in the present cases the prior rulings are directly in point and that the basis of those rulings is applicable to the present cases.[27]

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27. Petitioners would also point out that respondent, who seeks to distinguish taxpayers who received private rulings from those who did not, has in fact failed to apply consistently this new position

C.

Beyond their significance in confirming the meaning of his regulations, respondent's uniform, contemporaneous and extensive private rulings are determinative of what was a reasonable method of amortization.

Petitioners have previously noted that Section 125 (b)(3)(B) contemplated the promulgation by respondent of regulations specifying a "reasonable" method of amortization. Petitioners have also noted that Section 125 (b)(3)(A) permitted the taxpayer to select his own method of amortization, if reasonable.

Respondent in his regulations, Reg. 118, §39.125(b)-5(1953), prescribed his reasonable method of amortization and respondent, by his uniform private rulings, contemporaneously announced that such reasonable method encompassed amortization of bond premium to a special call price.

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nunciated in Rev. Rul. 56-398. In at least four Tax Court cases, the taxpayer involved had amortized bond premium to the special call price but had not applied for a ruling. *Maysteel Products, Inc.*, 33 T. C. 1021 (1960), *rev'd*, 287 F. 2d 429 (7th Cir. 1961); *Fabreeka Products Co.*, 34 T. C. 290 (1960); *Jack L. Sherman*, 34 T. C. 303 (1960); *Sadie S. Friedman*, 34 T. C. 456 (1960). (The decisions of Tax Court in the last three cases were reversed, 294 F. 2d 876 (1st Cir. 1961)). In all four cases the taxpayer had purchased bonds at a premium, amortized that premium to the special call price, and thereafter made a distribution of the bonds which entailed a double tax deduction (*e.g.*, gift to charity). In each case the Court of Appeals, reversing the Tax Court, found that nothing in the statute denied the double deduction. In *Maysteel*, involving Appalachian bonds similar to those involved in the *Gourielli* case, respondent stipulated, in effect, that if amortization of bond premium was permissible at all, it was permissible to the special call price. In *Fabreeka*, *Sherman* and *Friedman*, respondent did not question, either in his deficiency notice or at any later stage in the litigation, the taxpayer's use of the special call price. In none of these cases did respondent indicate any reason for failing to apply the new position which he has announced in Rev. Rul. 56-398.

The method of amortization selected by petitioners in the instant cases did not differ from that promulgated by respondent in his regulations and validated by respondent in his rulings.

It is petitioners' primary position that respondent, in determining that amortization of bond premium to a special call price was proper and constituted a reasonable method of amortization, was performing a legislative function and that, accordingly, such determination could not be altered retroactively. It is petitioners' alternative contention that, had respondent's determination been made administratively rather than legislatively, that determination would nonetheless be immune to retroactive reversal since Congress in 1954 chose to reenact the underlying provision of law, as so interpreted, without relevant change.

Wholly aside from the foregoing, it is further petitioners' position that respondent's uniform, contemporaneous and extensive private rulings—in establishing that amortization to the special call price was a reasonable method of amortization—are determinative of the issue presented herein: Under Section 125, a method of amortization can not have been reasonable for one bondholder but unreasonable for another similarly situated bondholder.

This obvious truth is illustrated with maximum clarity by an examination of the Record in the instant cases. On pages 51 through 65 of the Record, the exchange of correspondence in two typical Section 125 private rulings is set out. The special call price ruling in one of these situations is dated December 2, 1952; in the other it is dated October 16, 1953. Both rulings consider the special call price of Appalachian Electric Power Company First

Mortgage Bonds 3¾% Series of 1981. *These are the identical bonds which were purchased by petitioners in the Gourielli case.* Indeed, the Gourielli bonds were purchased on October 8, 14 and 23, 1953, exactly at a time when respondent was ruling that amortization of identical bonds to the special call price was proper and reasonable (R. 64-65). Yet respondent, who said "yes" in his October 16, 1953 ruling, has said no to Mr. Gourielli as to identical bonds bought at exactly the same time.

That respondent was uniformly granting favorable rulings on the reasonableness of amortizing bond premium to a special call price during the period which is here in question was not a secret known only to the select few. To the contrary, copies of such rulings were widely circulated. Just how widely is illustrated by the Findings of Fact of the Tax Court in the *Fabrecka Products Company*, 34 T. C. 290, 293-294 (1960), *rev'd*, 294 F. 2d 876 (1st Cir. 1961), where it is pointed out that an accountant who had received such a ruling in 1953 solicited clients for amortizable bond premium transactions by exhibiting a copy of his ruling. 30 to 35 of these clients decided to acquire callable bonds at a premium. It is not known how many more were shown the ruling letter but did not choose to purchase bonds. Respondent does not contend that his rulings were not widely circulated, nor does he contend that non-recipients of rulings did not purchase callable bonds at a premium in reliance upon the position announced in his rulings.

What is reasonable or unreasonable is a question of fact. Amortization of bond premium to a special call price cannot be a more reasonable method of amortization for Mr. Evans or Mr. Parnell than it is for Mr. Gourielli or Mr. Goldfarb. It cannot be a more reason-

able method for the many taxpayers who requested and received favorable rulings from respondent than it was for the many taxpayers who did not request from respondent the rulings which unquestionably would have been forthcoming.

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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APPENDICES

APPENDIX A

Statute Involved

Internal Revenue Code of 1939 as Amended by the Revenue Act of 1942, c. 619, §126, 56 Stat. 822; Revenue Act of 1950, c. 944, §217(a), 64 Stat. 941.

Sec. 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

• • • • •

(v) *Bond Premium Deductions.*—In the case of a bondholder, the deduction for amortizable bond premium provided in section 125.

Sec. 125. Amortizable Bond Premium.

"(a) General Rule.—In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond premium (determined under subsection (b)) on the bond for any taxable year beginning after December 31, 1941:

"(1) *Interest Wholly or Partially Taxable*—In the case of a bond (other than a bond for the interest on which is excludible from gross income), the amount of the amortizable bond premium for the taxable year shall be allowed as deduction.

• • • • •

(b) Amortizable Bond Premium.

(1) *Amount of Bond Premium.*—For the purposes of paragraph (a), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or an earlier call

date, with adjustments proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond. In no case shall the amount of bond premium on a convertible bond include any amount attributable to the conversion features of the bond.

(2) *Amount Amortizable.*—The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year.

(3) *Method of Determination.*—The determination required under paragraphs (1) and (2) shall be made—

(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

(B) in all other cases, in accordance with regulations prescribing reasonable methods of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary.

(c) Election of Taxable and Partially Taxable Bonds.—

(1) Eligibility to Elect and Bonds with Respect to which Election Permitted.—This section shall apply with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer has elected to have this section apply.

* * * * *

Appendix A

(B) Wholly Taxable.—In the case of any taxpayer, bonds the interest on which is not excludible from gross income but with respect to which the credit provided in section 25(a)(1) or (2), or section 26(a), as the case may be, is not allowable.

(2) Manner and Effect of Election.—The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner with the approval of the Secretary shall prescribe. If such election is made with respect to any bond (described in paragraph (1)) of the taxpayer, it shall also apply to all such bonds held by the taxpayer at the beginning of the first taxable year to which the election applies and to all such bonds thereafter acquired by him and shall be binding for all subsequent taxable years with respect to all such bonds of the taxpayer, unless, upon application by the taxpayer, the Commissioner permits him, subject to such conditions as the Commissioner deems necessary, to revoke such election. The election authorized under this subsection in the case of a member of a partnership shall be exercisable with respect to bonds of the partnership only by the partnership. In the case of bonds held by a common trust fund, as defined in section 169, or by a foreign personal holding company, as defined in section 331, the election authorized under this subsection shall be exercisable with respect to such bonds only by the common trust fund or foreign personal holding company.

APPENDIX B

PERTINENT PORTIONS OF REGULATION ISSUED BY THE COMMISIONER OF INTERNAL REVENUE PURSUANT TO SECTION 125(b)(3)(B), INTERNAL REVENUE CODE OF 1939

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§39.125(b)-1 Bond premium and amortizable bond premium. (a) Bond premium on any bond to which section 125 applies is the excess of the amount of the basis (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date. For determination of applicable call date see §39.125(b)-2.

* * * * *

§39.125(b)-2 Callable and convertible bonds. (a) The fact that a bond is callable or convertible into stock does not, in itself, prevent the application of section 125. For the purposes of such section, in the case of a callable bond the earlier call date will be considered as the maturity date and the amount due on such date will be considered as the amount payable on maturity, unless the taxpayer regularly employs a different method of amortization which is reasonable. Hence, the bond premium on such a bond is required to be spread over the period from the date as of which the basis for loss of the bond is established down to the earlier call date, rather than the maturity date. The earlier call date may be the earliest call date specified in the bond as a day certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer. A taxpayer who deducts amortizable bond premium with reference to a particular call date may not thereafter use a different call date in the

calculation of amortization deductions with respect to such premium.

* * * * *

§39.125(b)-5 Methods of amortization. (a) The determinations of the bond premium and amortizable bond premium on any bond to which section 125 applies shall be made in accordance with:

(1) The method of amortization regularly employed by the taxpayer, if such method is reasonable; or

(2) The method of amortization prescribed by this section.

A method of amortization will be deemed "regularly employed" by a taxpayer if the method was consistently followed in taxable years beginning before January 1, 1952, or if for taxable years beginning on or after such date a taxpayer who has never previously taken a deduction for amortization initiates in the first taxable year for which such a deduction is taken a reasonable method of amortization and consistently follows such method thereafter. * * *

(b) The method of amortization prescribed by this section is as follows:

(1) The bond premium on any bond to which section 125 applies shall be determined in accordance with §39.125(b)-1 and shall be computed as of the end of the taxable year (or as of the date of disposition or redemption of the bond, if it was disposed of or redeemed in the taxable year) but without regard to the amortizable bond premium for the taxable year; and

(2) The amortizable bond premium on such bond for the taxable year shall be an amount which bears the same ratio to the bond premium on the bond as the number of

months in the taxable year during which the bond was owned by the taxpayer bears to the number of months from the beginning of the taxable year (or, if the bond was acquired in the taxable year, from the date of acquisition) to the date of maturity or earlier call date. For the purposes of this subparagraph, a fractional part of a month shall be disregarded unless it amounts to more than half a month, in which case it shall be considered as a month.

* * * * *

§39.125(c)-1 Election. In the case of a corporation, the election provided in section 125 may be made only with respect to fully taxable bonds. In the case of a taxpayer other than a corporation, the election provided in such section may be made with respect to (a) fully taxable bonds only, or (b) partially tax-exempt bonds only, or (c) both fully taxable bonds and partially tax-exempt bonds. Such election shall be made by the taxpayer by claiming a deduction for the bond premium in his return for the first taxable year to which he desires the election to be applicable. No other method of making such election is permitted. If the election is so made, the taxpayer should attach to his return a statement showing the computation of the deduction. The election shall apply to all bonds in respect of which it was made owned by the taxpayer at the beginning of the first taxable year to which the election applies and also to all bonds of such class (or classes) thereafter acquired by him, and shall be binding for all subsequent taxable years. Upon application by the taxpayer, the Commissioner may permit him to revoke the election, subject to such conditions as the Commissioner deems necessary. * * *

* * * * *